ACCOUNTING ISSUES IN
COMPETITION ACT-2002

With special reference to the accounting terms used

1. Turnover
2. Value of assets
3. Profit

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PREFACE

The World Trade Organisation (WTO) has come into existence in the year 1995, as an umpire in the field of global trade for the member countries. The motive of WTO is free and fair trade. As a result of successive rounds of negotiations the tariffs have reduced substantially and may be fully withdrawn within time to come. But whether the free trade will remain fair is a question of debate and fear amongst developing and underdeveloped member nations.

In absence of tariff the only powerful tool available with the countries to control trade in a way to direct their economy in the manner they desire is the Competition Law, popularly referred to as Anti Trust Law in the Western Countries. The Competition Law plays a pivotal role in maintaining competitive atmosphere in the industry and trade.

At present all over the world there are near about 105 countries, which have introduced Competition Law. In India till recently Monopolies and Restrictive Trade Practices Act 1969, was used to control competition issues. However considering the limitations of that Act, in order to cope up with the challenges of global trade, Competition Act, 2002 has been introduced.

The investigation under the Act is based on verification of accounting data of the enterprises. Accounting is not a codified law, nor there are any set rules or standards, which are universally accepted. Depending upon the customary, traditions, precedents and need of the time, each country has developed its own accounting procedures. In India The Institute of Chartered Accountants India, New Delhi has issued various accounting standards. These accounting standards are not legally enforceable, but are framed with a view to have transparency in the financial statements placed before a user. Thus there is a need to arrive at some decisive definition of the various terms used under the Act.

The analysis in this study has been made in the light of the existing fiscal laws, court decisions, accounting standards and guidance material issued by the
Institute of Chartered Accountants of India, New Delhi. The aim of the study is to arrive at a cogent meaning to the accounting terms used in the Act.

As a student of the Post Qualification course on International Trade Laws and WTO of the Institute of Chartered Accountants of India, this study has been made as a part of practical training. I am overburdened with the help and guidance received from the Authorities of the Competition Commission of India, New Delhi during the course of training and this study.

I am grateful to Hon’ble Shri Vinod K. Dhall, Member, Competition Commission of India, New Delhi, for accepting my request to be associated with the CCI as an intern.

I am highly indebted to my esteemed mentor Shri Amitabh Kumar, IRS, Director General, for the inspiration and encouragement given for compilation of this study and for his in-depth critical analysis of various chapters. I would also like to express my sincere gratitude to Shri G. R. Bhatia, Ex-Addl. Director General, for his active support and advice. I am equally thankful to Shri Augustin Peter, Economic Advisor, for his invaluable guidance and encouragement.

I express my deep feelings to Shri M. M. Sharma, Addl. Registrar, Shri Unmesh Pahade, Ex-Asst. Director and all other staff members of the Competition Commission of India, New Delhi, for their overwhelming support and timely cooperation in giving present shape to this dissertation.

Last but not the least, I shall remain life long obliged by my Patron i.e. The Institute of Chartered Accountants of India, New Delhi, who has provided me this landing platform of The Competition Commission of India. With its recommendation only, I could get this opportunity to undergo practical training and enlighten myself in this newly emerged challenging field of the Competition Law.

New Delhi
February 14, 2007

CA Umesh H. Dixit
EXECUTIVE SUMMARY

1. The Competition Act, 2002 (in short ‘The Act’) has been introduced with the aim to control and prevent Anti-Competitive Agreements and Abuse of Dominant Position if indulged in India, by any person or an enterprise. It also regulates combinations that cause or likely to cause appreciable adverse effects on competition in India. The Act establishes the Competition Commission of India. (in short ‘The Commission’)

2. For Combinations that will be covered within the ambit of the Act, threshold limits have been fixed which are on the basis of Turnover achieved and Value of Assets owned by the parties jointly or by the group to which the parties belong or would belong. In case any enterprise is found to be engaged in an anti competitive practice, provision for levy of penalty has been made. (section 27). The penalty is turnover based in case of an enterprise individually, but in case of a cartel it would be levied on each of the member thereof, on the basis of comparative figure of turnover and profit.

3. Section 2(z) of the Act provides that for words and expressions used but not defined in this Act, and defined in the Companies Act, 1956 (1 of 1956) shall have the same meanings respectively assigned to them in that Act. For the purpose of study, apart from the Companies Act, the provisions of other existing tax laws and judicial decisions of various Courts have also been considered. After thoroughly analysing the various materials as discussed above, it is recommended that the contours of these three terms should be as under:

4. a) Turnover: Turnover shall comprise of gross invoice value of sales consisting of basic sales price, plus taxes levied if any. Amounts charged in the invoice itself e.g. packing and forwarding; material-handling charges etc. shall also be included. Sales returns if any shall be reduced. Amounts that are based on subsequent performance like discount, rebate etc., or bad debts should not be reduced. In case of an enterprise engaged in providing services gross invoice value of services charged plus the amount of service tax and any other charges levied if any, in the
invoice itself shall be considered to be turnover. Any subsequent deductions shall not be reduced.

b) **Value of Assets** : The term Value of Assets shall mean fair market value of all the assets taken together owned by the enterprise, as on the last day of the financial year under consideration. Even if assets are purchased on credit or on loan, but if the property therein has been transferred to the enterprise, the same shall be taken at its full value. In case the property has not been transferred then in such case, the paid up value should be considered.

c) **Profit** : Profits for the purpose of the Act, shall be Net Profit before tax as computed as per the normally accepted accounting principals and norms. In case of a cartel member if it is not possible to segregate the profit earned out of collusive agreement from the total profits, then the term profit for the purpose of the Act shall mean to be that proportion of total profits, which the cartel turnover bears to the total turnover.

5. Further relevant aspects like what has to be considered as Financial Year, Books of Accounts, Audited Books of Accounts etc., which have relevance in the quantification of above items have been discussed in depth in the study.
DISCLAIMER

This study report has been prepared by the author as an intern under the internship programme of the Competition Commission of India for academic purposes only.

The views expressed in the report are personal to the intern and do not necessarily reflect the view of the Commission in any manner. This report is the intellectual property of Competition Commission of India and the same or any part thereof may not be used in any manner whatsoever, without express permission of the Competition Commission of India.

New Delhi
February 14, 2007          (CA Umesh H.Dixit)

CHAPTER – I

INTRODUCTION

1.1 The Competition Act, 2002 (No. 12 of 2003) as published in Part II- Section 1, Gazette of India Extraordinary, on 14th January 2003, (in short “The Act”) provides for curbing and prohibiting anti competitive practices if indulged into by business enterprises and service providers either singly or in collusion.

1.2 Section 3 of the Act deals with control of Anti Competitive Agreements entered into by and between enterprises or persons, in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, if they cause or likely to cause appreciable adverse effect on competition in India. Section 4 deals with another form of anti competitive practice i.e. Abuse of
dominant position by dominant enterprises. The Act also aims to regulate combinations, popularly referred to as concentrations in the Western countries, which may take the form of acquisition, acquiring of control, merger or amalgamation. Sections 5 and 6 govern the provisions relating to combinations and regulations thereof.

1.3 The Act has wide applicability and not only Natural Persons, Partnership Firms, and Limited Companies but even Govt. Depts, Corporations established by or under any Central, State or Provincial Act, Local Authorities and even body corporate incorporated in a country outside India, have also been brought into its scope.

1.4 As a regulatory authority, the Commission may on receipt of complaint from any aggrieved party, or on receipt of voluntary notification in case of a combination, or on a reference made by the Central Government, State Government or a statutory authority or even sue moto carry out an investigation. Investigation would involve thorough scrutiny of the accounting data of the enterprise/s. Based on the outcome; it will be determined as to whether the enterprise/s is/are engaged in any Anti-Competitive practice, or abusing dominance or likely to abuse dominance. In case of combination the Commission would assess whether the combination if carried out would cause an appreciable adverse effect on competition in the relevant market in India.

1.5 As regards anti competitive agreements and abuse of dominant position, no threshold limits of exemption have been prescribed and any enterprise if found to be engaged in such activities shall be covered by the provisions of the Act. (Sections 3 & 4). However, a combination shall be covered only, in case the parties thereto or the group to which they belong or are going to belong after combination jointly have or would jointly have either turnover or value of assets exceeding the threshold limits prescribed. (Sections 5)

1.6 The threshold limits prescribed at present are based on the combined value of assets and turnover of the enterprises. The aim behind selection of turnover and value of assets as the criterion for assessment for the purpose of the Act is that both these indicators represent the economic power possessed by an enterprise. Depending upon the geographical area of operation of the parties to the
combination, they have to be quantified either in terms of Indian Rupees or US $. Three types of situations have been explored. Firstly in case the parties to the combination operate only in India, then their combined total turnover and the combined total value of the assets has to be quantified in terms of Indian Rupees. Secondly, if the parties operate in India as well as abroad, their combined total turnover and the combined total value of assets in India as well as outside in terms of US $. And lastly if the parties to the combination belong to or are going to belong to a group, then the above figures of the entire group have to be taken into consideration. If the group is operating only in India then the quantification has to be in terms of Indian Rupees. In case it is operating in India as well as outside then it has to be measured in terms of US $. For the limits presently prescribed under the Act, please refer Appendix ‘A’)

1.7 The limits so prescribed are subject to review by Central Government every two years, and in consultation with the Commission, by notification, they may be enhanced or reduced on the basis of wholesale price index or exchange rate fluctuation [(Section 20(3)]. During the course of study provisions of Antitrust laws in counties all over the world were looked into. It would be interesting to note that all over the world turnover and value of assets are the only two criterions that are considered as indicators of economic power of an enterprise.

1.8 As a result of investigation under the Act, if it is found that any enterprise is engaged in anti-competitive practice or is abusing its dominance, then in that case penalty provisions have been proposed. The penalty is to be levied either on the basis of turnover or in case of a cartel on each member thereof on the basis of turnover or profit made [Section 27(b)].

1.9 In view of the of background this study is made with the aim to arrive at the cogent and decisive meaning to the three terms namely;

1. Turnover
2. Value of Assets
3. Profit
The importance behind the need to exactly define these terms would in case of combination become more glaring in case of borderline cases. Say in case the combined turnover of the enterprises is Rs. 3,050 crores against the threshold limit of Rs. 3,000/- crores. In such a case the applicability of the Act itself would be a deciding factor. In case of a cartel if it is proposed to levy penalty then in order to minimise the rigor of the penalty, the enterprises will try to project these figures at lower levels. (For quantum of penalty that may be levied u/s 27 please refer Appendix C) In case of combination they will try to project lower value of assets and turnover in order to escape out of the applicability of the Act itself.

1.10 For any law to be effectively administered and applied, it is extremely necessary that its provisions are transparent, known in advance, uniform, impartial, properly administered and provide proper legal redressal to the person who is affected by it. The provisions should be unambiguous, self-explanatory, specific, uniform and exhaustive. A provision is featured in section 32, which says that the provisions of the Act are applicable even to the acts taking place outside India, which have an appreciable adverse effect on competition in India. The Act thus extends its jurisdiction even over foreign nationals, and entities established abroad, if they are found engaged in any acts having appreciable adverse effects on competition in India. This study is being made in view of the above background.

1.11 Accounting of an enterprise is done on periodical basis, usually a year, also referred to as financial year. The business transactions carried out are recorded in a prescribed manner and the records generated are referred to as books of accounts. Thus in order to arrive at the meaning of the above three terms, simultaneously as to what constitutes financial year and books of accounts, also needs to be understood. These aspects are also dealt with in detail in this study.

1.12 The provisions of section 36(1) of the Act, provide that the Commission shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908) but shall be guided by the principles of natural justice. One of the principles of natural justice provide for affording opportunity. Thus before arriving at any conclusion, the investigating authority will have to provide fair opportunity to the party who is subject to investigation to plead his case and to take into consideration the arguments and logic in the claim put before him. If the
investigating authority does not agree with it, then another principle of the natural justice i.e. speaking orders will have to be followed. The investigating authority will have to explain with justifying reasons as to why he does not agree with the contention of the person under investigation. In view of this it is necessary that the investigating authority is clear in his mind as to the interpretation of the various terms to avoid controversies and time-consuming litigation.

1.13 The term turnover has not been strictly defined in the Act. The terms value of assets and profit have not been defined at all. Rules of interpretation provide that in absence of a given definition words occurring in a statute have to be understood with reference to the objects of that statute and in the context in which they occur. Considering the fact that different laws are promulgated with different objects, the definitions given for the terms in one statute cannot automatically be imported for the interpretation of the same words in another statute. Neither the meaning, nor the definition of the term in one statute, affords guide to construction of the same term in another statute, and the sense in which the term has been understood in the several statutes does not necessarily throw any light on the manner in which the term should be understood generally. On the other hand it is a sound, and indeed, a well-known principle of construction that meaning of words and expressions used must take colour from the context in which they appear. {Sampath Iyengar’s Law of Income Tax (Revised by S. Rajaratnam), Bharat Law House 2005}

1.14 It will be also of interest to note the views expressed by various Courts as regards interpretation of statutory provisions. According to the Hon’ble Patna High Court “Where the provisions in one Act are similar to the provisions in another Act, the decisions interpreting the provisions in one Act would apply to the corresponding provisions in the other Act.” {CIT vs Chatterjee (MN) (1988) 170 ITR 87 Pat.} As per the verdict of Hon’ble Calcutta High Court “in fiscal statutes, unless the context otherwise warrants, same expression should be assigned same meaning occurring in different enactment where the colour, content and context of such statutes are same or similar ”. {CWT vs Bhaskar Mitter (1993) 202 ITR 612 (Cal.)} In a ruling given by the Hon’ble Karnataka High Court it is observed that in construing words, in the absence of a statutory definition, it would be open to look for the meaning by reference to definitions in sister legislation. {Shankar Construction Co. vs CIT (1991) 189 ITR 463 (Kar)} In view of the above opinion
of the Hon’ble Courts, one will be curious to travel through the provisions of other existing laws; as to what do they interpret these terms for their purpose.

1.15 The Appellate Body of the World Trade Organisation (WTO) in case of India – Patents (US), on treaty interpretation has emphasised that the principles of interpretation “ neither require nor condone” the importation of “words that are not there” nor the concepts that were not intended. Following the same decision, In the case of the EC-Hormones, the Appellate Body has paraphrased its statement that “ The fundamental rule of treaty interpretation requires a treaty interpreter to read and interpret the words actually used by the agreement under examination, and not words the interpreter may feel should have been used.”

1.16 Based on the above discussion, in the subsequent chapters while trying to define the scope of each of the above three terms under the Act, the provisions of other fiscal laws especially Income Tax Act, Central Excise and Customs Act and Sales Tax Act have been discussed. It would be relevant to consider the provisions of these laws, since for the purpose of their assessment, they consider the same accounting data, which an investigating authority shall use under this Act. The meanings have been assigned to these terms by the other laws, which shall be useful for the purpose of the Act, have been discussed in detail.

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CHAPTER - II

MATERIALS AND METHODS

2.1 Initially personal discussions with the various Authorities at the Competition Commission of India, New Delhi were held. The purpose of the discussion was to ascertain exactly the objects and purpose of the Act. On the basis of discussions held the various books and study materials were looked into and the views of the Anti Trust Laws in various countries were noted. Based on the conclusions drawn from these materials time to time discussions were held with the Authorities.

2.2 The web sites of various Inter National Bodies like World Trade Organisation (WTO), Organisation for Economic Co-operation and Development (OECD),
CUTS, The Institute of Chartered Accountants of India, were from time to time visited to get appraised of the latest development in the field. Also the Anti-Trust Laws of the various countries, judicial cases and other relevant material hosted on the web site were looked into.

2.3 The various books and reference material at library of the Competition Commission of India, The Institute of Chartered Accountants of India, New Delhi were referred to.

2.4 Reference was also made to the available material from the erstwhile Anti-trust Law of our country, i.e. The Monopolies and Restrictive Trade Practices Act, 1969.

CHAPTER - III

BOOKS OF ACCOUNTS

3.1 Before going into the main discussion it will be of interest to discuss other related issues having direct bearing on the main discussion. Explanation (c) to section 5 provides that the value of assets shall be determined by taking book value of the assets as shown, in the audited books of account of the enterprise. Now the first question is what are books of accounts and second when they are said to be audited.

3.2 Section 2(8) of the Companies Act, 1956 defines “Books and Paper and Books or Paper”. Accordingly, it includes Accounts, Deeds, Vouchers, Writings and
Documents. Looking into the provisions of Income Tax Act, 1961, the Finance Act, 2001, has w.e.f. 01.06.2001, introduced section 2(12A) that defines the term “books or books of accounts” as “Books or books of accounts include ledgers, day books, cash books, account-books and other books, whether kept in written form or as print outs of data stored in a floppy, disc, tape or any other form of Electro-magnetic data storage device”

3.3 With the introduction of the above definition, the extent and scope of the term has become very wide to include not only manual records but electronic records also. It will be of interest to note that the Income Tax Act is in force since 1961, but as to what happened to introduce this definition after such a long time i.e. 40 years of enforcement. It has been clarified in the Circular No. 14/2001, dated 12th December 2001 that with the passing of Information Technology Act, 2000, the Income Tax Act has provided definition of “books of accounts” and “documents” in section 2, so as to include electronic records within the meaning of these terms. Thus, with the mind boggling revolution in the information technology during the last decade that needs no elaboration, has also forced the fiscal law like Income Tax to amend its provisions.

3.4 On reading the said section 2(12A) of the Income Tax Act, again a reader would get stumbled with the words “other books”. The decision of the Income Tax Appellate Tribunal (Nagpur Bench) would help to throw light on this aspect. In a decision given by the Bench in the case of Pyarelal Gaur Vs. Commissioner of Income Tax, it has been held that any record maintained by the assessee from which net taxable income can be deduced shall be construed to be books of accounts. The scope of the term books of accounts is thus very wide so as to include any accounting data. Thus, an investigating authority will be free to go through any accounting record maintained by an enterprise and it will be considered to be books of accounts. But the matter is not solved; a controversy will further arise as to when and which books of accounts shall be treated to have been audited.
3.5 To decide this issue, audit report u/s section 44 AB of the Income Tax Act 1961, popularly known as tax audit report would be of help. As per the provisions of section 44 AB every assessee carrying on business in case his total sales, turnover or gross receipts exceed Rs. 40.00 lakhs, or in case of a person carrying on profession if his gross receipts exceed Rs. 10.00 lakhs in any previous year is required to get his books of accounts audited and obtain a report from a chartered accountant. In view of the high threshold limits prescribed under the Act, it is almost certain that every set of accounts that would be investigated shall be supported by tax audit report. In form no. 3CD, which is annexure to the report at query no.9(b) the auditor has to report as to what are the books of accounts maintained. At query no 9(c) the he has to report the books of accounts examined.

3.6 Thus an investigating authority can satisfy himself by going through the report as to the books of accounts marinated by the that enterprise and further as to whether they are audited or not.

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CHAPTER – IV

FINANCIAL YEAR

4.1 Another related issue that needs to be discussed is what is a financial year. As per explanation (c) to section 5, the value of the assets has to be determined by taking the book value as shown, in the audited books of account of the Enterprise in the Financial Year immediately preceding Financial Year in which the date of proposed merger falls. According to the provisions of section 27(b), the penalty shall be based on the average turnover or average profit of the last three preceding financial years. Hence it will be necessary to exactly arrive at the period that should be construed to be financial year, so that in case of combination investigation can be carried out with reference to that period.
4.2 The Act is silent as to what is Financial Year. The Companies Act 1956, in section 2(17), defines it as “in relation to any body corporate, the period in respect of which any profit or loss account of the body corporate laid before in annual general meeting is made up, whether that period is a year or not.” The definition is thus flexible, as it does not prescribe any particular period to be reckoned as Financial Year. If the enterprise under investigation is a body corporate, the definition can be safely adopted. However, in case the enterprise is not a body corporate, then the question will arise as to what period should be construed to be financial year. The terms “enterprise” [Section 2(h)] and “person” [Section 2(l)] have wide coverage under the Act which include not only body corporate but also Govt. Dept., Individual, HUF, Partnership Firm, Association of Persons, Local Authorities etc. Hence it will not be appropriate to uniformly adopt the above definition of financial year for the purpose of the Act.

4.3 The General Clauses Act, 1897 (10 of 1897) in section 3(21) defines “financial year” as the year commencing on the first day of April. Hence in India the period of twelve months commencing on 1st day of April, and ending on the 31st day of March is the financial year. Now the position is clear as far as Indian entities are concerned. However, the Act covers not only Indian, but also entities incorporated outside India. It is quite likely that in other countries, different period may have been prescribed as financial year.

4.4 Say in case of a combination there are two enterprises, of which one incorporated in India follows year ending on 31st day of March, but the other one a foreign enterprise, follows 31st December as financial year as per the law of that country. In such a situation does the Act mean that the financial year has to be reckoned with reference to the country of its incorporation? Or irrespective of its country of origin, every enterprise for the purpose of investigation under the Act shall have to reconstruct its accounts up to 31st of March of the preceding year in which the proposed merger falls.

4.5 Let us further elaborate the above situation by an example where an acquisition is proposed wherein the acquirer is an Indian enterprise and the enterprise to be acquired is an outsider. They are operating in India as well as abroad. The
The position of aggregate assets and turnover at the close of respective financial year is as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Assets (Million US $)</th>
<th>Turnover (Million US $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Enterprise</td>
<td>400</td>
<td>1000</td>
</tr>
<tr>
<td>(31.3.2006)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Enterprise</td>
<td>50</td>
<td>400</td>
</tr>
<tr>
<td>(31.12.2005)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>450</strong></td>
<td><strong>1400</strong></td>
</tr>
</tbody>
</table>

Apparently the units are not covered by the provisions of section 5(a)(i)(B) since both the criteria are not fulfilled.

4.6 However if the turnover of the foreign enterprise is also considered on Indian financial year basis and its turnover for the period 01.04.2005 to 31.03.2006 is US $ 600 million In that case the position as on 31.03.2006 will be as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Assets (Million US $)</th>
<th>Turnover (Million US $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Enterprise</td>
<td>400</td>
<td>1000</td>
</tr>
<tr>
<td>Foreign Enterprise</td>
<td>50</td>
<td>600</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>450</strong></td>
<td><strong>1600</strong></td>
</tr>
</tbody>
</table>

Thus, if the figures are considered on Indian financial year basis, the acquisition crosses the threshold limits, but if they are considered with reference to the respective country, then the enterprises cannot be said to have crossed the limits. In such a case it will be difficult to decide whether the combination hits the provisions of section 5 or not.

4.7 In developed laws like European Merger Regulation, reference is made to the preceding financial year. In practice, the European Commission generally prefers to look at the most recent audited accounts. [European Community Law of Competition by Bellamy & Child, (2001). London Sweet & Maxwell] Thus, it can be inferred that EC law considers financial year to be that latest accounting year of which the audit has been completed.
4.8 However in the Indian context taking such a view will not be appropriate. Firstly due to the fact that the definition of ‘person’ is having a very wide coverage. It covers entities under all most every legal status. The various laws in force prescribe the scope of the audit to be carried out under its provisions. The Companies Act, 1956, Co-operative Societies Act, Public Trust Act (of various states), prescribe audit for all those entities that are registered under them. The tax laws i.e. Income Tax Act, 1961 and the VAT laws (Sales tax) in various states prescribe audit in case the turnover exceeds prescribed limit, or in case of any benefit/concession is claimed or under special circumstances. Thus some enterprises are subject to double audit i.e. under the parent law under which they are registered and another under the tax laws which govern them. Conversely some of the enterprises e.g. local authorities, are not required to get their books of accounts audited at all. Thus the EC approach is not suitable in India.

4.9 To overcome all such situations, considering that the provisions of the law extends to only those acts that have appreciable adverse effects on competition in India, it will be rational to adopt the definition given in the General Clauses Act. Thus Financial Year purpose of the Act shall be the period of 12 months commencing on 1st day of April and ending on 31st day of March of the next calendar year. In case an enterprise closes its books of accounts on any other day, it will be required to re-construct its accounts for purpose of investigation. Adopting the said approach will also lead to submission of comparable data.

4.10 Looking the problem from another angle, the Companies Act 1956, gives a time period of 6 months from the end of the financial year for completion of audit of accounts and for adoption by General Body. The Income Tax Act gives the 31st day of October to be the last date for completion of audit and furnishing of returns. In case a voluntary notification for combination is filed in the month of April, then it will be quite likely that the accounts for the year ending 31st of March will be un-audited, and may not be even audited within the further period of 90 days. Then in such a case the EC approach to consider the most recent available audited accounts will be the advisable approach.

4.11 To conclude it is recommended that in order not have any controversy on this aspect, the Commission should adopt Financial Year to be the period of 12
months, ending on 31st of March immediately preceding the year in which the proposed merger falls. In case an Enterprise which is party to combination reckons any other date as its close of financial year, then such an Enterprise will have to reconstruct its accounts, get them audited and furnish the report certifying the truth and fairness of the accounts presented. However, where a situation as discussed in para 4.10 arises flexibility should be provided as adopted by the EC Law, that the period for which recent available audited accounts are available should be considered for determination of value of assets, as well as turnover.

4.12 After deciding as to what period shall be construed to be a financial year, further question will arise as to which should be the preceding three financial years. This is also equally important since the penalty proposed u/s 27 (b) shall be with reference to the turnover or profit of the preceding three financial years. Now the date with reference to which preceding three financial years has to be considered for the purpose of the Act, will have to be decided. Thus, whether it will be the date on which the anti competitive agreement is entered into, or the date on which the said agreement has come to light, or complaint has been received. It may even be with reference to the date on which investigation has commenced or the year in which the investigation has been concluded.

4.13 With regard to the above issue it will be first necessary to note that a cartel is a long term arrangement with the intention to reap exorbitant profits by collusive agreement amongst its members. Thus, the penalty shall be levied for each year of existence of the cartel, which means with reference to each year existence of the cartel, the penalty will be levied with respect to the immediately preceding three financial years from the year under consideration.
CHAPTER - V

TURNOVER AND RELATED ISSUES

5.1 In view of the above background, the further in-depth analysis of the main topics of study is being made. In this chapter the term Turnover and related issues have been dealt with. As per the Webster’s dictionary turnover means “Amount of business accomplished “ It is also defined as “a completed commercial transaction in course of business, also the money receipts of a business for given period.” In common parlance turnover and sales are interchangeably used.

5.2 As a result of revolutionary development in the field of information technology the traditional concept of trade i.e. sale and purchase of commodities has been
absolutely changed. Not only goods but also services form a major portion of the business activity. Banking, Insurance, Telecommunication, Travel and tourism are examples of the service sector, which have occupied a dominant role in the day to life of common man. In many cases the goods and services are intertwined in an inseparable way. Thus, the term turnover will have to be looked into a broader aspect covering goods as well as services.

5.3 Rapid advancement in technology, widespread globalisation of business activities, and competition amongst the enterprises to expand their market share, have brought in newer and newer concepts in the field of accounting also. The services especially in the field of software development are transferred not in physical form but in electronic form. Services like airlines/railway booking, hotel reservation, money transfer can be carried out online without even accessing the service provider. Thus the traditional form of business has totally changed and keeping into consideration the above aspects, finality with regard to the meaning of the term turnover will have to be reached.

5.4 A business enterprise or a service provider on completion of the transaction issues invoice towards money due to him on account of sale of goods or provision of services. This gives elaborate information about the rate, quantity, quality, terms of delivery etc. The accounting is done on the basis of the invoice issued.

5.5 Before going into further discussion let us see how an enterprise issues sales invoices.

A. Basic Sales Price: (10 units @ Rs.100/- each) Rs. 1000
B. Add : Excise duty @ 16 % Rs. 160
C. Total Rs. 1160
   Add : Sales Tax (VAT) @ 4 % Rs. 46
   --------
D. Total Rs. 1206
   Add : Packing and Forwarding Rs. 94
   --------
E. Total Rs. Rs. 1300

From a pure accounting angle turnover is Rs. 1300/-. However, the basic turnover is Rs. 1000/-, which is considered for the purpose of levy of excise duty. For the purpose of sales tax, the turnover is Rs. 1160/-. There are further possible
adjustments on account of discount; rate difference etc. A service provider will add amount of service tax (if applicable) to the value of service provided.

5.6 In India it is not mandatory under the provisions of indirect taxes to reflect separately the figures of tax levied, and hence the above invoice can be issued in the following form also.

A. Sales Price: (10 units @ Rs. 120.60 each) Rs. 1206
B. Add : Packing and Forwarding Rs. 94
C Total Rs. Rs. 1300

Even the invoice can be issued covering entire ingredients as under

A. Sales Price: (10 units @ Rs. 130 each) Rs. 1300
B Total Rs. Rs. 1300

5.7 The first type of invoice is referred to as exclusive invoice, the second and third one are referred as inclusive invoice. It is also quite likely that throughout the financial year, all the invoices might not have issued unanimously in the same fashion i.e. either inclusive or exclusive. The enterprises operating in more than one state generally follow inclusive method, since rates of sales tax vary from state to state, and in order to maintain uniform final selling price, invoices are raised inclusive of all taxes.

5.8 On going through the various laws, it is seen that there is no specific definition of the term turnover given in any of them, irrespective of the fact that turnover is the deciding factor in any financial assessment. Also none of the laws mentions of the components of turnover. Hence quantification of turnover has always remained a subject matter of controversy. The Act, in section 2(y) has defined the term turnover as under:

**Section 2(y): Turnover includes value of sale of goods or services**

It can be seen that the words used say that the turnover includes value of sale of goods and services, which means that turnover is something else, of which the value of sale of goods and services is one of the component. The definition is incomplete and is thus subject to legal debate. It is very important to clearly
define the term, because section 5 covering combinations, which takes into its wings value of assets and turnover, puts the word “or” in between. This makes it crystal clear that for crossing threshold limit it is not necessary that both the conditions have to be satisfied simultaneously, but even if either of the conditions is satisfied the provisions of the Act are attracted.

5.9 Taking resort to the provisions of Section 2(z) of the Act, let us go to the provisions of Companies Act, 1956 (1 of 1956). Part II of Schedule VI of the Companies Act deals with the provisions of the requirements as to the presentation of Profit and Loss account. In clause 3(i)(a) of the said Part II, it is has been stated as under:

““The turnover, that is, the aggregate amount for which sales are effected by the company, of sales in respect of each class of goods dealt with by the company ----------------Profit and Loss Account.”

5.10 Now one will conclude that, The Companies Act, 1956 clarifies that turnover is the aggregate of sales and thus no further discussion is needed. However considering the discussion in para 5.2 to para 5.4, it will have to first determine the definition of sales itself, since it is subject to too many interpretations. There are provisions in other laws and court decisions that need to be looked into before arriving at any conclusion.

5.11 The primary law in India with reference to which accounting statements are basically prepared is the Income Tax Act, 1961. Under Income Tax Act, the definition of the term turnover has been already legally analysed by the Hon’ble Supreme Court. In the case of Chowringhee Sales Bureau Pvt. Ltd.; Vs CIT [(1973) 87 ITR 542 SC] it has held been that “ Collection of tax in the hands of the assessee is a business receipt and forming part of the profit and is liable to tax ” The Hon’ble Supreme Court in the case of Sinclair Muclair Murrag and Co Pvt. Ltd., Vs CIT [(1974) 97 ITR 615] and also in Punjab Distilling Industries Ltd. Vs CIT (1959) 35 CTR 519] has held that “ The amount of tax recovered by the dealer or the seller when it forms an integral part of the sale, it is nothing but a trading receipt. It is the nature and quality of receipt and not head under which it is taken or entered in the accounts of the assessee would be determinative and decisive.”
5.12 Similar view has been held in the cases of Sahaney Steel and Press Works Ltd., and others (228 ITR 253 SC) and in CIT vs Motipur Sugar Factory Pvt. Ltd., (154 ITR 259 SC). In all these cases it has been confirmed that whatever accounting treatment the assessee gives in its books of accounts to the sales tax collected, sales tax forms part and parcel of the sales value and thus is a part of turnover.

5.13 After considering the legal view under the Income Tax Act that sales tax is a component of sales, it will be interesting to note what does the Sales Tax Law itself opinions about this issue. It will be surprising to note that the opinion is exactly in reverse. Communication Centre, Department of Sales Tax, Govt. of Maharashtra has in a answer to a query replied that the turnover does not include tax. (Source query no. 314 and 315, downloaded from http://salestax.maharashtra.gov.in )

5.14 Continuing further with the Income Tax Act, 1961 Section 44AB makes it mandatory for all assessees whose total sales, turnover or gross receipts as the case may be exceed Rs. 40.00 lakhs, to get their books of accounts audited. On reading the provision carefully, it is seen that the wordings used are ‘sales/turnover/gross receipts’. It is thus clear that section 44 AB of the Income Tax Act presumes turnover to be some thing different from sales, otherwise it would not have distinctly mentioned both the words separately.

5.15 In a decision on the provisions of section 44 AB of the Income Tax Act, the Hon’ble Bombay High Court in the case of Chief CIT Vs Vijaykumar Maheshwari (HUF), has held that even if the purchases exceed Rs,. 40.00 lakhs, the assessees are required to get their books of accounts audited as the turnover has exceeded Rs. 40.00 lakhs. Hence in view of the Bombay High Court even purchases also constitute turnover. The Hon’ble Supreme Court dismissed the Special Leave Petition (SLP) filed by the Income Tax Dept, against the said order of the Bombay High Court. Thus, the Apex Court is also of the opinion that turnover would mean total purchases made during the year. (228 ITR 257)

5.16 The term turnover is also used under the Income Tax Act, under section 80 HHC, which allowed deduction of profits, earned by an assessee on its export turnover upto 31.03.2005. As explained, in case if the turnover includes both i.e.
indigenous as well as export turnover, then profit from export business has to be arrived at the same proportion the export turnover has to the total turnover.

\[
\text{Export Profit} = \frac{\text{Total Profits} \times \text{Export Turnover}}{\text{Total Turnover}}
\]

5.17 Circular 564 dated 05/07/1990 issued by Central Board of Direct Taxes in para 6 clarifies that “Export Turnover” under the existing provisions means the sale proceeds (excluding freight & insurance), receivable by the assessee in convertible foreign exchange. Thus, for the purpose of section 80 HHC, the Income Tax Act, the meaning of the turnover is Sales. So it can be easily inferred that under the Income Tax Act, the criterion of turnover is different for different sections. There the definition of Turnover is flexible and has to be applied depending upon as to which provisions of the law are being referred to.

5.18 Thus on going through the provisions of various laws in force in India, the conclusion is that there is no unanimity in between them. Thus there is no definition which can be directly adopted. Therefore for the purpose of the Act, based on all the above discussion a logical conclusion will have to be worked out.

5.19 Going further beyond to have a global view on the issue, if we look into the laws in other countries, it is seen that as per Article 5 of the European Merger Regulation, the term Turnover is defined to be “the amounts derived by the undertakings concerned in the preceding financial year from the sale of products and the provision of services falling within the undertakings ordinary activities after deduction of sales rebates and of value added tax and other taxes directly related to turnover. The regulation also specifies that for the purpose of computation of turnover, the intra group operations have to be excluded. In doing so the aim is to reflect only transactions with the third parties. The European Community has rules for turnover with respect to specific sectors i.e. Insurance, Banks and Mixed Groups. Turnover is replaced by the total amount gross annual premiums for insurance companies, and by gross income for banks and other financial intermediaries.
For the purpose of study apart from the provisions of EU Laws as above, the anti-trust laws of various other European Countries, Latin American Countries, Australia, Japan etc. was referred to. On going through these laws it is seen that in majority of anti-trust laws world-wide, the term turnover is said to be net of tax. This is on the analogy that indirect taxes are consequential and are not the part of the enterprises business. The enterprise has to operate as a trustee of the Govt. to collect and pay tax. This means the basic value of goods is considered to be turnover all over. Thus, in Indian context it will have to be decided as to whether the turnover should be exclusive or inclusive of taxes which are directly levied or leviable.

Considering the situations as discussed in para 5.5 and 5.6 above regarding method of invoicing adopted by enterprises, in Indian context it will be advisable to adopt the definition of turnover to be the gross value of sales inclusive of indirect taxes. It will be simple to work out not only for the Commission, but also to the enterprises under consideration. Also the above-cited judicial decision of the Supreme Court of India, which is a law of land, supports this view.

After coming to a conclusion as to what should be deemed to turnover for the purpose of Act, the next pertinent question is as regards adjustments to be made to the value of turnover arrived as above. One such issue is claim for sales returns, which is accepted by the Sales Tax, as well as Customs and Excise authorities, for which reversal credit is granted. Under the Central Excise Act, if there is a sales return then on receipt of the goods credit can be obtained under rule 16.

To visualise as to how the effect may be perceived, for example let us assume that sales effected in the month of February are received back in the month of August by way of sales return. The books of accounts on 31st of March are closed; the audited balance sheet is adopted in the month of July. Now since the balance sheet has been already adopted and books of accounts having been closed, no effect of any event occurring after the balance sheet date can be given to. The Excise Law will give credit for the above duty and will reduce the turnover for
the month of February. Thus, the turnover assessed under the Excise Act, and that as per the books of accounts for the same financial year will differ.

5.24 The Customs Authorities deal with the cases of dumping of goods by foreign enterprises. Dumping is the act of an enterprise of selling goods at a lower price in the export market, than the prevailing prices in the local market. The margin of dumping is the difference in the sales value at which goods are sold in the local market and at which they are sold in the export market. Thus, for arriving at the normal value of turnover in case of the enterprises which are subject to levy of anti dumping duty, the dumping margin as assessed by the customs authority is added to the value of turnover.

5.25 In order to avoid heavy taxes, there is a universal tendency for under invoicing. Under invoicing is different from dumping, because in dumping the price paid by the purchaser for the goods is as per the invoice raised and is a unilateral act. While in case of under valuation it is carried out in consortium by both the parties. In such cases the balance consideration is paid off the record. When a case of under valuation is detected, the customs authorities levy customs duty on the full value of the goods as per the prevailing market rates. For the purpose of the Act, the difference will have to be added back in order to arrive the figure of turnover.

5.26 In case during the course of investigation the investigating authority finds that any transaction has not been entered into by the enterprise at arm’s length price, then in that case the difference between the market price and transaction price will have to be added back to the value of the turnover.

5.27 Under the provisions of the Income Tax Act, 1961, in case of certain class of assesses like retail traders, transport operators, civil construction contractors etc. This is called as presumptive taxation. In case of an assessee who opts to file return under these provisions, no books of accounts are required to be maintained. In absence of books of accounts, no question arises any audit also. Then in case of such cartel members, in absence of books of accounts and audit thereof, what would constitute to be turnover needs to be clearly provided by the Act.
CHAPTER VI

FOREIGN EXCHANGE CONVERSION

6.1 Section 5 of the Act, dealing with combinations specifically states that in case of multiple country transactions, turnover and value of assets shall be computed in terms of US Dollars, which is an internationally accepted currency. Considering the pace of liberalisation resulting in globalisation of business activities especially as a result of development in the field of information technology, there would hardly be any enterprise that would not be having multi country dimension activities. There is thus every likely hood that almost in every case the criteria will have to be judged in terms of US $ only. The conversion and computation of turnover in US $ terms would involve further interpolation and the major question revolving in every case will be the exchange rate fluctuation.
6.2 As regards conversion of turnover in terms of US $, in case the transactions are limited; the conversion can be easily made. Say an aircraft manufacturing company has sold 20 aircraft during the financial year. Though volume wise the turnover is large, conversion will not pose any problem due to limited number of transactions. But where the transactions are numerous, carried out on day-to-day basis, conversion will be a cumbersome process. It may not only be cumbersome but rather an impossible task considering the magnitude of transactions.

6.3 But since the Act requires that the figures have to be expressed in terms of US $, an acceptable method will have to be developed so as to abide with the provisions. One way will be to apply the exchange rate on the last day of year. However this will not be an appropriate method. The reason being that in India, and even in most of the nations, accounting is done on historical cost basis. The exchange rate fluctuates every day and it will not be justifiable to apply same exchange rate to all the transactions entered throughout the year. Even otherwise since sales are effected round the year, it will not be practically possible to convert turnover for every sale invoice by adopting the exchange rate of that particular day and time. Thus, in such an eventuality, the via media will be to apply average rate i.e. average of maximum and minimum rate during the year.

6.4 Applying average rate will also not be a correct method. This will lead to haphazard results in case an industry is seasonal industry or say for part of the year it was shut down, when the exchange rate was at its peak or at lowest level. For other reasons say like govt. policies, natural calamities, war etc., the exchange rate might have abnormally fluctuated during the year. However barring such eventualities though this method will not lead to 100 % correct results but would at least lead to some rational conclusion.

6.5 As per the European Community Law of Competition, when a merger is notified turnover figures are to be submitted in Euros; the conversion calculation should be made using the average exchange rate for the period in question or the official exchange rate for those currencies in the Euro zone. Thus use of average rates seems to be the best alternate solution for currency conversion problem.
6.6 Apparently the above proposal will be simple to accept. However, the matter will become complex when the enterprise operates in more than one country and does business in more than one currency. The major problem will arise if the currencies are having direct exchange facility available with US $. Let us take one example. A company is incorporated India and is dealing in cotton shirts. The selling price per shirt is fixed at Rs. 500/- and is not subject to change under any circumstances. The turnover consists of one shirt sold in India, one in Singapore and one in United States. The exchange rates are

1) Indian Rs. 50 = 1 US $
2) Indian Rs. 40 = 1 Singapore Dollar
3) US 1$ = Singapore 1.20 Dollar

The shirt will be sold in India for Rs. 500/-, in US for US $ 10 and in Singapore for SP $ 12.50. If one shirt is sold in each country then the turnover in Indian Currency will be:

1) Indian 1 x 500 = Rs. 500/-
2) US 1x 10x 50 = Rs. 500/-
3) Singapore 1 x 12.50 x 40 = Rs. 500/-

Total turnover Rs. 1,500/-

Now if the turnover of Singapore is directly converted in US $ then, the position will be as under;

1) Indian 1 x 500/50 = 10.00
2) US 1x 10 = 10.00
3) Singapore 1 x 12.50/1.20 = 10.42

Total turnover US $ 30.42

Because cross currency rates normally have speculation margins an exercise like above will give different results. The matter will become further complex, in case of a country, which does not have direct convertibility with Indian Rupees as well as with US $
CHAPTER - VII

ASSETS : NATURE AND CLASSIFICATION

7.1 Value of Assets is another criteria for the purpose of section 5 of the Act. Explanation (c) to section 5, clarifies that the value of assets shall be determined by taking the book value of assets as shown, in the audited books of account, of an enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, as reduced by any depreciation.

7.2 The need to determine the value of assets is for the reason that the intention of the Act is to assess the economic power possessed by an enterprise. The explanation at the outset it says that the value of assets shall be determined by taking the book value as per the audited books of accounts of the enterprise. However, if the
enterprises is owner of any intangible assets as specifically described like brand value, goodwill, copyright, permitted use etc then in that event a valuation of these assets will have to be carried out.

7.3 Going further, the explanation specifically enlists various intangible assets and the word used is “shall include” and thus one may infer that the list is exhaustive. However, as per the rules of interpretation, the use of the words has to be looked into with the object of the law and not as per its dictionary meaning. The list is thus illustrative only, and in case any intangible asset apart from the above is owned by an enterprise, then its value will have to be included. In short all assets in whatever form owned by an enterprise shall be taken into account for determination of value of assets.

7.4 That, the Act relies fully on the audited books of accounts of the enterprise. However it would be advisable to go through the auditor’s report in order to ascertain whether the auditors have given any adverse opinion with regard to the basis of accounting adopted in respect of the assets by the enterprise. In case any such remark is observed then in that case it will be necessary to make proper adjustment of the effect to the value of assets.

7.5 Though the term assets is used in common parlance to be property which is owned by an enterprise, there are further sub classifications depending upon the nature, purpose, utility etc., and are disclosed in the balance sheet under the respective group. While presenting the balance sheet they are classified as under:

a) Fixed Assets  
b) Investments  
c) Loans and Advances  
d) Current Assets  
e) Misc. Expenditure (to the extent not written off)  
f) Debit Balance of Profit & Loss Account.
Item no. (f) debit balance in the profit and loss account represents accumulated loss and is not an asset under any circumstance. For the purpose of value of assets only items included in (a) to (e) will be covered. Apart from the above classification other major distinction is tangible and intangible assets. For the purpose of presentation in balance sheet, the intangible assets are included in the group of fixed assets.

7.6 An investigating authority will have to verify as to whether the enterprise, which is subject to investigation, has disclosed the assets in accordance with the accepted accounting principles and norms. That the assets are classified and included in the proper group to which it belongs. Just the nature of asset will not be material but also the nature of the business will also have to be taken into account. Say for example in case of a car manufacturer the motor cars on the last day of the financial year will be classified under the head stock in trade. However in case of other enterprise it will be classified under the head Fixed Assets. Similarly money deposited in shares and securities with a view to earn dividends there from will be classified under the head Investments. However, in case it is the business of the enterprise to deal in shares and securities on a regular basis, then they will be classified under the head current assets as stock in trade. Thus, the accounting treatment will differ depending upon the nature of the asset.

7.7 In India, The Institute of Chartered Accountants of India, New Delhi is the primary body, which frames and issues the accounting standards. Although the said accounting standards are not legally binding, but they serve as a useful guide for accounting purpose. The Auditors are required to qualify their report in case of any deviation from the accounting standard. If there is any deviation from the accounting standards or the accepted norms, the audit report will contain the auditors remark and qualification. Thus the audit report will be a helpful document for the investigating authority to make proper adjustments to the value of assets if required.

7.8 However Investigating Authority cannot just remain satisfied that the enterprise under consideration has followed the applicable accounting standards with respect to its jurisdictional country, but will have to cross verify the information and data available and produced before him. Also under the Act, the definition of the term
person or enterprise is so wide that it takes into its fold each and every entity engaged in any business activity whether registered or not, in India as well as outside. Even limiting the discussion to Indian scenario, most of the accounting standards are not applicable to non-corporate enterprises. Also enterprises like Individuals, Hindu Undivided Family, Partnership Firms, Local Authorities are not subject to any compulsory audit. Thus in such cases the investigating authority will have to apply his own tests and checks to confirm that that the value of assets as disclosed by the enterprise is correct. Naturally these checks will be based on accounting standards only.

7.9 Apart from Accounting Standards the Institute has also from time to time issuing Guidance Notes and Auditing And Assurance Standards (AAS), which should be referred for assistance. (Please refer Appendix ‘C’ and ‘D’) It shall advisable that an investigating authority by taking support of the relevant guidance material as discussed above should apply his tests and checks and to arrive at the acceptable figure of value of assets.

CHAPTER VIII

DETERMINATION OF VALUE OF ASSETS

8.1 The Act has made it amply clear that the book value of assets as appearing in the audited books of accounts will be considered. But assessing whether the value has been properly reflected or not, it will have to be confirmed whether the various constituents of the assets have been properly accounted for or not. However, as regards intangible assets, the Act does not prescribe that the value as per the books of accounts shall be adopted. Hence it will be necessary to determine the value of intangible assets separately.

8.2 **Valuation of Fixed Assets:** Fixed assets consist of tangible as well as intangible assets. Let us first see the valuation of tangible fixed assets. As per the
Accounting Standard –10, (AS 10) ‘Accounting of Fixed Assets’ issued by the Institute of Chartered Accountants of India, New Delhi, a Fixed Asset has been described to be an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

Simultaneously it will be also necessary to see what are the components of fixed assets and in the books of accounts they are recorded at their full value or not. Since the Act places its full reliance on the Companies Act 1956, it will be of interest to first see what does that law recommends as regards the components of fixed assets. Schedule VI of the Companies Act, 1956 prescribes format of balance sheet and gives guidelines about the disclosure to be made and methodology to be adopted in the preparation of Balance Sheet.

8.3 As regards disclosure of fixed assets, it is prescribed that, the fixed asset shall comprise of the original cost and the additions thereto and deductions there from during the year and the total depreciation written off or provided up to the end of the year. In case any of the fixed asset has been including the additions and deductions thereto have been acquired from a country outside India and in consequence of the change in the rate of exchange at any time, or after acquisition of such assets, there has been an increase or reduction in the liability of the company, as expressed in Indian currency for making payment towards the whole or part of the cost of assets, or for repayment of the whole or part of the monies borrowed in any foreign currency, the value of the assets shall be correspondingly increased or decreased. Thus, the book value of fixed assets shall be in accordance with the above norms.

8.4 The Institute of Chartered Accountants of India, New Delhi, has come out with a publication titled Members Ready Reference Year 2001-2002, wherein guidelines for accounting of fixed assets have been prescribed. These guidelines also provide the same criteria as regards the constituents and valuation of fixed assets as discussed in schedule VI of the Companies Act.

8.5 Further it should also be confirmed that:
a) The cost of self-constructed or self-fabricated assets consists of cost of material labour, supervision, and all other costs, directly allocable to bring the asset to its working condition for its intended use.

b) In case of assets acquired in exchange or partly in exchange, the cost of the asset acquired shall be the fair market value or at the net book value of the asset asset given up, whichever is more clearly evident, and adjusted for any balancing consideration. Expenditure on fixed assets incurred subsequently is included in the value of assets only if such expenditure increases the future benefits from the existing assets beyond its previously assessed standard of performance.

c) If any of the assets are re-valued at any point of time earlier, then the purpose and basis for revaluation should be looked into.

d) The value of fixed assets acquired on hire purchase terms, should be adopted at their cash value i.e the value of instalment paid.

e) In case of joint ownership the value of the extent of the enterprise’s share in such assets should be valued after verifying the terms of agreement for share.

f) Where several fixed assets are purchased for a consolidated price, it will have to be seen that the consideration has been apportioned to the various assets on a fair basis. The basis of apportionment should be seen. This will be important in case the various assets are subject to different rates of depreciation.

g) The amount paid for know how, plans, layout and design of buildings and/or design of the machinery i.e. supplementary costs should be included in the value of that asset.

h) It will be always advisable to obtain valuation reports from the experts as a supportive evidence.

8.6 Apart from above other relevant factors like location of the assets, nature of industry, installed capacity etc., should also be looked into. There is also a
possibility that some of the fixed assets might have been received free of cost, say by way of donation or contribution. In such cases the value for the purpose of the Act, to be adopted should be the market value as on the date of investigation. In case of assets that are acquired out of grants, or subsidies, their value will have to be considered equivalent to the cost of grant or subsidy. In case the investigating authority is of the opinion that the value is different suitable adjustments may be made to the value reflected in the books of accounts.

8.7 **Valuation of Intangible Assets:** International Accounting Standard (IAS –38), defines an Intangible Asset as “an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.” According to US GAAP, intangible assets are defined as “certain long-lived rights and competitive advantages developed or acquired by a business enterprise” The Institute of Chartered Accountants of India in its Accounting Standard 26 on Valuation of Intangible Assets, has described that an enterprise controls an intangible asset if it has the power to obtain future economic benefit flowing from the underlying resource and also can restrict the access to others to those benefits.

8.8 In case the intangible asset is outrightly purchased then it will be reflected in the books of accounts at its cost less the depreciation charged till date. The investigating authority should go through the terms and conditions of agreement entered into by the enterprise with the licensing agency in this regard. The document will contain the terms agreed like period of license, chargeable annual fees, manner in which the asset may be exploited by the user for his benefit. Say in case of copyright, the number of copies that may be published annually, or in case of a trade mark the quality of the product or the service, subject to which it may be affixed. The capacity of the user to legally restrict others from exploiting the said asset is the right given to the owner or licensed user of an intangible asset under the respective laws. This capacity can be judged from the legal rights the enterprise has acquired which can be enforced in the court of law.
8.9 The value of the intangible assets is to be ascertained on the basis of the expected future economic benefits which will arise to the enterprise by way of super profits due to the ownership and use of these assets for the purposes of business. Super profits means profits earned over and above the normal profits. As regards approach for valuation is concerned, the first hurdle on the way is the non-physical form of intangible assets, which makes the process complicated. The matter of computation of future economic benefits is a process of estimation and is more open to subjective assessment of the person who is entrusted with the job. Another distinguishing feature of the intangible assets is that neither they can be dismantled in parts. Also they do not have any alternative use. Say a Patent can be used for production of that particular product only. A Trademark can be used for affixing on a particular product or services only. These are the special features of intangible assets that will have to taken into consideration before going towards the main topic of our discussion i.e. their valuation.

8.10 The principles for valuation as are applicable for the valuation of tangible fixed assets equally apply to intangible assets i.e. if the intangible asset is acquired by way of outright purchase, its acquisition value shall be the cost paid. The cost of acquisition of shall be further increased by the expenses like professional fees, legal fees, directly attributable on making the asset ready for it intended use, including any import duties and other taxes.

8.11 If any intangible asset is acquired in exchange for shares or other securities, the value of the asset should be determined at its fair value, or the fair value of the securities issued whichever is more clearly evident. In case of an asset is acquired on amalgamation, the value to be recognised should be the market price, which is usually the current bid price. In case of an asset is acquired out of government grant at free of charge or at nominal consideration, then its value should be recognised at normal value or at acquisition cost. Any expenditure that is directly attributable should be added to the cost. In case an intangible asset is acquired in exchange of another assets, then in such case, the cost of the asset acquired should be recorded at its at fair market value or at the net book value of the asset given up, whichever is more clearly evident, and adjusted for any balancing consideration.
8.12 When it comes to quantification of other internally generated intangible asset i.e. to say patent or permitted use, the guidance note’s recommendation is that it should be first identified the point of time when the future economic benefits will be generated by the asset and that the cost of such asset should be reliably identified. An internally generated intangible asset has two stages of generation. The first stage is research stage and the second one is the development stage. As the economic benefits cannot be with certainty be demonstrated at the research stage, the Accounting Standard recommends that an intangible asset should not be recognised at research phase. An intangible asset arising from Development should be recognised only if an enterprise can demonstrate in a collective manner that the asset is technically feasible of availability for use or sale. The intention of the development is to complete the intangible asset and use or sell it.

8.13 **Amortisation of Intangible Assets:**

The concept of depreciation, which is applicable with respect to the fixed assets, is equally applicable to the intangible assets. It is not wear or tear but the efflux of time that lowers down the economic benefits realising out of the intangible assets and that a proper provision has to be made for this depletion. The identification of year wise diminution in the capacity of the asset to generate economic benefits and writing off the amount of depletion to the profit and loss account as expenditure is called as amortisation. The amortisation can be made on straight-line method, written down value method or even on the unit of production method depending upon the beneficial life of the asset. To overcome the dispute that may arise with regard to assessment of beneficial life of an intangible asset, determination of amount to be written off, and for bringing in simplicity and uniformity, the Finance Act, 1998, amended section 32 of the Income Tax Act, 1961, whereby the intangible assets are allowed depreciation at the prescribed rate. The rate of depreciation presently prescribed is @ 25 % on WDV basis.

8.14 The period over which such asset will be written off is called as amortisation period. Thus it is recommended that the amortisable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. From the agreements entered into with the grantor the period of benefit an
enterprise can enjoy can be easily ascertained. In case the period of enjoyment by an enterprise cannot be ascertained then or if the assets are self generated, it is generally presumed that the useful life of an intangible asset shall not exceed ten years from the date when the asset is ready for use. The amortisation should commence from the year in which the asset is available for use.

8.15 As discussed in the case of tangible assets, since the accounting is done on historical cost basis and thus the cost or written down value as reflected in the books of accounts may not be a real indicator of the worth of an intangible asset. The said situation is equally applicable in case of intangible assets also.

8.16 To clarify, supposing a drug company is manufacturing a generic painkiller. The said drug is very popular in the market and is sold on a large scale. There are other companies selling the same drug but their market share is substantially low. Since the drug is generic there is no question of any different patented ingredients put in by the first company. Thus the turnover achieved is a result of its brand image. If the company has purchased the brand earlier then its book value must be very low as compared to the market value of the brand. The dominance of the company in the market is as result of the brand image i.e. the market value of the brand, which is not at all comparable with the book value.

8.17 There can be even a reverse case. Say a company has acquired a patent by paying heavy licence fees. Subsequently with the introduction new technology new competitive products have been launched in the market whereby the patented product does not have an appreciable market share. However in order not to bring this fact before the shareholders the company is writing off the said asset at normal rates of depreciation and the book value of the asset is much higher than its realisable value.

8.18 The valuation should be made on the basis of super profits earned by the enterprise by using that intangible asset. The profit earned by the product manufacturedemarketed with the use of the intangible asset should be first ascertained. Then out of such profit the normal profit or return on capital employed (ROI) should be reduced. The resultant figure is the super profit i.e. the profit earned as a result of the use of the intangible asset. Considering the future
economic life of the product or service, rate of inflation etc., the super profit should be given weightage and the value of intangible asset should be arrived at.

8.19 It is a challenging task to correctly arrive at the value of an intangible asset. The investigating authority will not be aware of the peculiar situations of a particular industry. It would be therefore advisable to simultaneously obtain valuation report of an expert to substantiate the value adopted by the investing authority.

8.20 Since the Act has made it explicitly clear that the value as per the audited books of accounts will be considered and hence the value of Investments, Loans and Advances and Current Assets will be adopted as appearing in the audited books of accounts. There is one more group appearing in the audited books of accounts i.e. Miscellaneous Expenditure (to the extent not written off or adjusted). These items include expenses which though revenue in nature have utility for a period exceeding one year. The nature of expenses is that of revenue, but are capitalised and written off over a period of time and hence they are also termed as “Deferred Revenue Expenses”. Their utility period is generally taken in between five to ten years. These include items like Testing Expenses, Preliminary Expenses, Development Expenses, Interest paid during Construction Period, Share Issue, Underwriting and Brokerage Expenses, Discounts allowed on issue of shares or debentures etc.

8.21 A controversy will arise as to whether these items should be considered to be assets at all for the purpose of calculation of threshold limit prescribed in section 5. A view may be taken that since they do not have any realisable value in the outside market, they should not be included in the value of assets. It will depend on the facts of each case as to whether the same should included or excluded. In either case it will be obligatory on the part of the investing authority to give his justification as to why they are included or excluded.

8.22 In a recent decision given by the Income Tax Appellate Tribunal, Delhi ‘G’ Bench in the case of Hero Honda Motors Vs. Joint Commissioner of Income Tax, Special Range-2, New Delhi, it has been held that when any expenditure is treated as a deferred revenue expenditure, it presupposes that concerned expenditure, creating benefit is in revenue field and is a revenue expenditure but considering its enduring benefits as well as the fact that it does not result in
creation of new asset or advantage or enduring nature in capital field, same is required to be treated distinctly from Capital Expenditure.[ (2006) 103 ITD 157] If the above view is considered the miscellaneous expenditure is not capital asset.

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CHAPTER - IX

RELEVANT ASPECTS IN COMPUTING VALUE OF ASSETS.

9.1 At the time of determination of value of assets an investigating authority may come across extraordinary situations having an impact on the method to be adopted, the information that should be obtained, basis of valuation, components of assets etc. Some such probabilities are relevant to discuss.

9.2 It is a common tendency amongst the taxpayers to evade tax by inflating expenses in order to reduce the real profit. One such mischief, which is played by the enterprises, by claiming excessive expenditure by way of debiting capital expenditure to profit and loss account under repairs and maintenance or any other suitable head. On this issue innumerable cases have reached to the Courts to
decide the nature of the expenditure i.e. revenue or capital. To verify this aspect, the tax audit report u/s 44AB of the Income tax Act, will be a helpful document to the investigating authority to verify whether any such capital expenditure has been charged off to profit and loss account. In said audit report, the auditor has to inform whether any capital expenditure has been debited to profit and loss account. If the auditor has reported any such items, then value of the assets will have to be increased to that extent. Also the assessment orders made by the Income Tax Authorities for last four to five years should be called for and verified to see whether any addition to the income has been made during the course of assessment on account of disagreement by the assessing officer with the accounting treatment adopted by the assessee to its various expenses. The appellate results in this regard should also be verified.

9.3 Bonus Shares have market value, but since they are received free of cost, their value is not reflected in the books of accounts. In such case for the purpose of computation of value, if the shares are quoted then the market value on the last day of the financial year should be adopted. In case of unquoted shares the book value or intrinsic value should be adopted. Derivatives are financial instruments which may not be recorded in the books of accounts. How to ascertain the existence of such items and to determine their value them will also needs to be specifically provided for.

9.4 As per the provisions of Income Tax Act (1961) depreciation is not charged on assets individually but on block of assets basis at the rate of percentage specified to that particular block. An item of asset acquired during the year is added to the block and any disposal/sale/deletion is reduced there from. The depreciation is allowed on the net value of the block. Sometimes it may happen that one or few items of asset are disposed off at a higher value than the written down value of the entire block. In such case the credit balance in the block on the last day of the year is transferred to profit and loss account as short-term capital gains u/s 50. Now though the value of the assets for the purpose of Income Tax Act has become Nil, there still remain assets physically present which do not appear in the books of accounts. The value of such items, which are physically present but not reflected in the books of accounts shall be required to be included for the purpose of determination of value of assets.
9.5 Further under the Income Tax Act, 1961 certain items are allowed 100% depreciation. They include items like purely temporary constructions, air & water pollution control equipment, wooden parts used in artificial silk manufacturing machinery, cinematography films, items used in mines and quarries etc. Though for the purpose of Income Tax Act, their value has become nil and not appearing in the books of accounts, they still remain physically present with the enterprise. Such items will also have to be included in the value of assets by allocating a fair value.

9.6 Another item in the case of a banking industry is that of assets acquired in satisfaction of claim. Against loan provided to a customer as a security some property, by way of mortgage or hypothecation is taken. In case of default, the bank takes the possession of the said asset. In the books of accounts their value is reflected at the value of the unpaid loan amount, which may be more or less than their fair value. The valuation of such assets will be a tricky job.

9.7 In case of general insurance, the insurer on payment of claim takes over the damaged insured material. Such items do not have much realisable value, nor it is an item purchased for resale purpose. Whether the value of such scrap items acquired in settlement of claims shall be included in the value of assets needs to be clarified.

9.8 Claims accepted but not recovered, unrealised amount against court decree granted have also value but are not included in the books of accounts since contingent. Depending upon reasonable certainty of realisation, it will be proper to consider the value of such items on a reasonable basis.

9.9 In case of Govt. Companies registered under the provisions of section 617 of the Companies Act, 1956, the accounts are subject to audit only by an auditor appointed by Comptroller and Auditor General of India. It is well known fact that in majority cases, the appointment of auditors for Govt. Companies remains in arrears for 2-3 years or even for a longer period. The explanation (c) to section 5 says that the value of assets shall be determined by taking the book value of assets as shown in the audited books of accounts of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls. In case of a Govt. Co., whose accounts are not audited for the immediately
preceding previous year, then what basis the Investigating Authority will take needs to be clearly defined. In such cases as per the EU norms, the latest available audited accounts may be an acceptable proposal to determine the value of assets.

9.10 The same facts are applicable in case of Co-operative Societies whose audits are pending for want of appointment from Co-operative Registrar and also in case of private companies and partnership firms, whose audits may be pending for some reason or the other, say because of resignation or death of the auditor.

9.11 In case of a banking company there are items, which are reflected on both sides of the balance sheet, they are termed as contra items. Example of such an item is “Bills for Collection, being Bills Payable” appears on the Liability side, and “Bills for Collection, being Bills Receivable” appears on the assets side. It is the same transaction the amount of which is to be collected on behalf of an outsider, and paid to another outsider. The banks are work as an intermediary in between the two parties. Banks carry out this business for the sumptuous commission they earn. Bills for collection are neither asset nor the liability of the bank, but are reflected in the balance sheet. Bank Guarantees issued are also reflected on both sides of the balance sheet as contra items. Whether such items will be considered as Asset for the purpose of the Act, needs to be clarified.

9.12 The definition of “Person” provided in section 2(l) (ix) includes a local authority. The local authorities (Municipal Corporations, Gram Panchayats etc.,) do not prepare their annual financial statements in the form of Balance Sheet and Profit and Loss Account, but prepare only a Receipt and Payment Account. They also do not maintain books of accounts on double entry system. In absence of a Ledger Account, nowhere the total value of assets held by them is reflected. Thus, it will not only be difficult but rather an impossible process to quantify the value of assets as well as the turnover in such cases.

9.13 The Companies Act 1956, gives a time period of six months from the end of the financial year to complete audit and for adoption of accounts by General Body. The Income Tax Act gives the 31\textsuperscript{st} day of October to be the last date for completion of audit and furnishing of returns. In case a voluntary notification for combination is filed in the month of April, then it will be quite likely that the
accounts for the financial year ended on immediately preceded 31st of March will be un-audited. If it is assumed that timely compliance is made by the parties, and thus within the further period of 90 days the investigating has to be completed and order has to be passed. Then which set of financial statements and books of accounts will be the basis adopted needs a clarification.

9.14 In view of the changed business scenario new type of financial instruments have emerged. Derivative is one such instrument whose value changes in response to designated criteria say, interest rate, stock price, commodity price, mortgage rate, currency rates etc. Forward contracts, Swaps and Option are the examples of derivatives. Their value is ascertained on the settlement day. In case a forward contract is entered in the previous financial year by an enterprise, which is subject to investigation and the settlement day fixed for the contract is not over on the day of conclusion of investigation. Then how the above derivative will be valued and what exchange rate will be applied needs to be clarified.

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CHAPTER - X

PROFIT

10.1. In case of a cartel having entered into any anti-competitive agreement, the Act provides for levy of penalty on each member, be it a producer, seller, distributor, trader or service provider. The quantum of penalty proposed is either three times the amount of profit made out of such agreement or ten percent of the average turnover of the cartel for the last preceding three financial years whichever is higher.

10.2. The term Profit has not been defined by the Act. The ordinary meaning attached to it is excess of income over expenditure or an amount of savings in a business transaction. Profit is often referred to as the bottom line. Net profit is calculated
by taking revenues and adjusting thereto the cost of doing business, depreciation, interest, taxes and other expenses, showing what the company has earned (or lost), in a given accounting period. It is also called as net income or net earnings (source investorswords.com). The question is what has to be referred to as the profit made out of anti competitive agreement. For exact levy of penalty, it is necessary to correctly ascertain turnover as well as profit made. The language used by the proviso to section 27(b) is vague as it just concludes by saying profits made.

10.3. When financial statements are drawn; the figure of profit is arrived at three points of time with different meaning attached to each of them. Firstly out of the gross revenue, cost of sales and direct expenses are reduced, the resultant figure is Gross Profit earned by the enterprise. From the figure of gross profit, indirect expenses of the nature of administrative, financial, selling and distribution expenses, charges and allowances like depreciation are reduced. The resultant figure is the Net Profit also referred to as Profit before Tax. Net profit subject to various adjustments attracts income tax. After reducing tax liability from the net profit what is arrived at is Profit after Tax. This is real earning of an enterprise. Higher the profit after tax better is the financial position. Out of profit after tax dividend is distributed and other appropriations are made.

10.4 The Act is silent as to whether it intends to levy penalty with reference to gross profit, net profit or profit after tax. The proviso to section 27(b) simply says profit made out of such agreement. If gross profit is considered to be profit made for the purpose of levy of penalty, it shall not be a rational approach. Because apart from cost of sales and direct expenses various other indirect expenses are required to be incurred in order to conclude the transactions entered into. Gross Profit is not the savings, but is the level playing field for an enterprise.

10.5 If saving is the criterion to be considered one will argue profit after tax to be the fairest approach since it is the net savings of the enterprise i.e. the real earnings. However it has to be taken into consideration that in India tax on income is not charged at uniform rates. Depending upon the nature of business activity, legal status, geographical location etc. the rates of tax vary. For promotion of industries and overall development, the Income Tax Act, 1961 has come out with
various assessee friendly schemes like tax holiday for units established in Free Trade Zone (Section 10A), Special Economic Zones (Section 10AA), Export Oriented Undertakings (10B) etc. These enterprises enjoy 100% tax exemption and thus their profit before tax and profit after tax will be the same. However another unit which is engaged in exactly identical activity will not be entitled to get tax exemption because, it may not be located in the designated area.

10.6 There is also provision by which loss under one source of income is allowed to be set off against income under the same or other head of income. (Section 71) Also unabsorbed brought forward loss and depreciation are allowed to be carried forward and set off against subsequent years income and in case the loss is not fully set off then irrespective of having earned income during the year the assessee is not required to pay any income tax. (subject to provisions u/s 115 JB in case of corporate assessee) Thus, in such case profit before tax for the year shall be the same as per the profit after tax.

10.7 If it is prescribed that for the purpose of levy of penalty profit will be considered to be profit after tax then in cases as discussed above the enterprises will demand credit for the notional tax liability. In order to have clarity and to overcome situations as discussed above it will be advisable to prescribe “profit before tax” to be “profit” for the purpose of section 27.

10.8 Looking from another angle that would substantiate the argument of “profit before tax” to be considered to be “profit” for the purpose of section 27 is that the provisions say “profit made out of such agreement”. Tax is consequential and only if there is profit there will be tax. By using the words profit made out such agreement the Act has made it amply clear that there is no scope for consequential adjustments.

10.9 Now even if we arrive at the conclusion that profit made shall be the profit before tax, question remains as to how to compute it. In case the enterprise is engaged in only one product line and the profit as reflected in the profit and loss account is the profit made out of the cartel agreement, the matter will be easy. However, the issue will become complex, when there are more than one product lines/activities. As regards turnover it will be easy to compute from the sales invoices, but for computing profit how to allocate common expenses for each product line/activity
will be a problem. For example salary is paid to General Manager for services rendered to the enterprise as a whole and it cannot be bifurcated into pieces and allocated activity wise.

10.10 Another such item that involves difficulty in allocation is depreciation. In case of business involving multiple activities, assets are used commonly. Office building, furniture, vehicles are used commonly for the entire business, then to allocate share of depreciation for the business done under the anti-competitive agreement will be difficult job. Also in case of block of assets, which item is used for the anti-competitive activity and which is not or the proportion of use if the same asset is used for more than two products or activities it will be a difficult task to allocate the exact share of depreciation.

10.11 As discussed above there is a general tendency amongst the enterprises to artificially inflate expenses, in order to project lower profits to reduce the burden of tax. Indirectly it will also help to reduce the rigor of the penalty. Hence it will have to be ensured that there is no manipulation in the books of accounts and records. Income tax assessment orders passed in the previous years will reflect the disallowance / additions made by the assessing authorities, so as to get an idea as to whether the enterprise is indulged in such type of manipulation and tampering with its books of accounts. Any concealment proceedings u/s 271(1)(c) of the Income Tax Act, if initiated and confirmed should also be looked into. Concealment means any income that has not been voluntarily disclosed by the assessee but has been detected by the assessing authority.

10.12 For ascertaining exactly as to what the “profit” means for the purpose of the Act, the further aspect to be looked into is the method of accounting employed i.e. whether mercantile or cash. The hybrid system of accounting, which was earlier allowed, is now not permitted by the amended provisions of section 145 of the Income Tax Act. Secondly it has to be confirmed whether the enterprise is following accepted accounting standards. There are certain accounting concepts also like going concern, accrual, matching etc., which have to be strictly followed in order to arrive at the exact figure of the profits.
10.13 As far as the Act is concerned, it can be inferred that the framers of the law do not intend to go in much detailed analysis. What is simply intended is that the excess of revenue generated over the cost shall be considered as profit for the purpose of levy of penalty. However, method of accounting i.e. cash or mercantile will have to be considered for computing the profits earned by the cartel out of the impugned agreement. This is so because the accounting is being done on going concern basis, i.e. the concern will continue to operate in longer period and will not shut down its operations in the near future. Thus, all the expenses and incomes which have bearing on the profit or loss of the accounting year but are expected to be paid or received after some time period are required to be recorded on accrual basis so as to arrive at the exact quantum of profit for a particular accounting period.

10.14 Since the cartel is also a long term agreement with a view reap substantial profits, it will be advisable to compute the profits of the cartel members on going concern basis, based on mercantile system of accounting in accordance with the provisions of schedule VI of the Companies Act, 1956.

CHAPTER XI

ISSUES IN COMPUTATION OF PROFITS.

11.1 The pertinent question involved in computation of profit for the purpose of the Act, is segregation of total turnover and impugned turnover and normal profits and impugned profits. For the purpose of levy of penalty since a comparison has to be made of the turnover and profit it will be necessary to exactly determine both the figures. The turnover of the preceding three years is comparatively easy to compute. However, the computation of profit is extremely complex. The business transactions are consolidated one. Expenses are incurred which are common to normal as well as cartel turnover. It will be a difficult job to segregate the common expenditure i.e. cost of administration, proportionate depreciation,
other levies and charges to apportion to compute the exact profit of the transactions entered into by the impugned agreement. Thus filtration of cartel profits from total profits will be a tedious task for the investigating authority.

11.2 In such cases it will be advisable to adopt the method of proportionate profits. Accordingly the profits out of the cartel business will be computed to be the proportion of total profits that cartel turnover has to total turnover. This method is a recognised one and the Income Tax Law for the purpose of determination of profits for the purpose of section 80 HHC use the same methodology.

11.3 However the cartel members may not reap super profits just by effecting additional sales. Rather they will earn more by hoarding and reducing their turnover. By creating artificial scarcity in the market they will earn more. In case a company is dealing in only one product and is deliberately reducing its turnover or not utilising its full capacity then how to distinguish between normal profits and cartel profits will be a difficult job to assess. The investigating authority depending upon the facts of each case will have to take his decision in this regard. It will not feasible to set in advance standard norms for computing cartel profits in view of the above situations.

11.4 A further question is that the proviso to section 27(b) provides that the penalty shall be imposed on each member of the cartel. For this purpose profit and turnover of each of the member of the cartel will have to be worked out. A possibility cannot be denied that during the course of investigation all the members of the cartel might not have been revealed. It is quite likely that the whistle blower might have intentionally not disclosed the name of one or few of the members. Then in such an eventuality if subsequently any cartel member who was not a party to the investigation is detected, his investigation will also have to be carried out. If on conclusion of his investigation it is found that there arises a difference in the turnover and /or profit of the members whose investigation has been already concluded. In that case it may lead to the variation in the quantum of penalty recoverable from them. In case there is an excess recovery earlier, whether the parties to the original investigation will be refunded their excess share
of penalty? However it is pertinent to note that the Act does not contain any provision of grant of refund.

11.5 Another issue that will arise is in cases as discussed above is that there shall arise need to reopen the earlier concluded proceedings. There is no provision in the Act to reopen the concluded proceedings. There is also no provision in the Act for protective assessment which may be substantiated afterwards.

11.6 Valuation of closing stock in trade is one of the pivotal issues in computation of profit and is equally important in case of investigation under the Act, because, year wise profit has to be computed. In the block period of three years, it will have to be assessed as to whether the value of opening stock in the first year and in the third year value of closing stock of the impugned transactions have been properly quantified or not. For valuation of stock in trade, there are other methods like Average Cost, First in First Out (FIFO), Last in First Out (LIFO), Base Stock, Standard cost and so on. However, in India, the Income Tax Act, 1961 in compliance with which mostly the accounting is carried out, prescribes only either cost or market price whichever is low. Since the members of cartel may be having various legal status say, a Company, a Co-operative Society, Individual, HUF etc., it will be advisable to use the accepted method under the Income Tax Act, i.e. at cost or at market rate which ever is lower, since the Income Tax binds all classes of assesses.

11.7 Another issue that will be of consideration is that under the Income Tax Act, certain incomes are allowed to have been earned on deemed basis. The provisions of estimation of income on presumptive basis are in short discussed as below.

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Section</th>
<th>Nature of Business</th>
<th>Income Estimated</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>44 AD</td>
<td>Civil Construction business if turnover less than Rs. 40.00 lakhs</td>
<td>8 % of the turnover</td>
</tr>
<tr>
<td>2.</td>
<td>44 AE</td>
<td>Transport operator having less than 10 vehicles</td>
<td>Rs. 3500/- p.m. for heavy and Rs. 3100/- for other vehicles</td>
</tr>
<tr>
<td>3.</td>
<td>44 AF</td>
<td>Retail Trade, turnover less than Rs. than Rs. 40.00 lakhs</td>
<td>5 % of the turnover</td>
</tr>
</tbody>
</table>
4. **44 B**  Shipping Business by Non Residents
   - 7.5% of the freight receipts in India, and freight on shipping at Indian Ports.

5. **44 BB**  Business of providing services, facilities or plant and machinery for oil prospecting and production
   - 10% of such receipts for provision received unless covered by sections, 42, 44D, 115A and 293A

6. **44 BBA**  Business of operation of air craft
   - 5% of freight received or receivable in India or for carriage from any place in India.

7. **44 BBB**  Business of civil construction etc., in turnkey power projects, by foreign companies.
   - 10% of the amount paid or payable to such assessee.

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Thus, in such cases since the income is to be assessed on presumptive basis, there is no need to maintain neither any account books nor any requirement for conduct of audit is necessary. If such kind of Enterprises are found to be members of the cartel, then how their profits will be ascertained. Or whether in such cases the profits estimated under the Income Tax Act will be taken to be profits for the purpose of this Act also needs to be clarified.

11.8 However even if above view is considered the, levy of penalty under the Act is on actual basis and not on presumptive basis. The law clearly says that the Profits Earned and not the Estimated Profits or the profits deemed to have been earned. But in absence of any books of accounts how to compute the profits will be the question.
CHAPTER – XII

CONCLUSION

12.1 The report has defined the accounting terms in the context of the Competition Act, and has elaborated as to what should be the constituents of the three accounting terms. The analysis has focused primarily on accounting issues but has discussed other relevant aspects, which would also have to be simultaneously taken into consideration. This will work not only as a guide to the investigating authority, but would also serve as a mentor to the enterprises who would fall within the ambit of the law. Since the Act takes into its fold local as well as foreign entities which are not subject to other Indian Laws, the above study would
be of helpful basically to outsiders to appraise exactly what the Act intends with reference to the accounting terms used.

12.2 This Act will take cognisance of all those matters, which will have a bearing on the competition in India. This study paper is prepared considering the existing accounting standards in India. However, taking into consideration the fact that, the Act is going to cover even acts taking place outside India but having an effect on competition in India, the provisions need to be weighed with the International Accounting Standards so as to have more effective implementation.

12.3 Since the terms are not defined the parties that may be affected by the law would before the Appellate Authorities and Courts, will try to take shelter of technical grounds rather on merits and would continue their oppressive tactics as before. This will defeat the very purpose for which the Act is implemented. Thus, all accounting as well as legal terms needs to be clearly defined so that the parties do not get the benefit of doubt.

12.4 As regards the Valuation of Assets is concerned the valuation of tangible is that way easy to understand and to quantify. However, the valuation of intangible assets is a tedious job and will always be subject to debate and dispute. Thus, in case of valuation of intangible assets it would be advisable to take the help of an outside expert.

12.5 The provisions of section 5 when are required to be applied with regard to the group are a little bit difficult to operate because; it involves the computation of turnover and value of assets of the group as a whole. To assess both the criteria for a group consisting of even say 5 enterprises by applying the various tests in the discussion made in the various chapters would not only be a complicated but a highly challenging task.

12.6 It is also very much necessary to exactly ascertain the above values not because they are the threshold limits, which decide the applicability of the Act, but there are certain other necessary powers with which the law is not presently equipped. Thus the efforts of the investigating authority should not remain castles in air by not having the support of the other regulatory provisions. One of such provisions
is the re-opening of the concluded investigations, and time limit of such reopening. Secondly in case of investigation into a combination, the time limit of 90 days at the disposal of the investigating authority is very limited. Thus there is a need to empower the investigating authority to conclude the proceedings in a protective manner. The substantive orders can be passed subsequently on receipt of requisite information. Provisions with regard to grant refund, levy or allowance of interest are also not provided in the Act.

Since the time at the disposal of the investigating authority is very short, in case one of the parties to the combination is an outsider, then it will not be difficult but shall be time consuming to scrutinise its audited finical statements and would involve delay in concluding the proceedings.

To overcome such a situation many Countries have entered into mutual Antitrust Enforcement Assistance Agreements. It will be helpful for our Act also if we enter into such agreements with various countries, so that at the time of investigation of a combination having a multi country dimension, the assistance form the respective country can be solicited. Similarly we can also provide assistance to them in case an Indian Enterprise is a party to a combination in a foreign country.

Under the Income Tax Appellate Tribunal Rules, Income Tax Appellate Tribunal is the last fact finding authority and the matters will be on further appeals entertained by the courts only case it involves a question of law. No matter which is a question of fact can be contested before the Courts. As per the recent amendments to the Income Tax Act, it should not be only a question of law, but it should be a substantial question of law that can be entertained by the Courts. Such provisions need be introduced in the Act so that only those aspects, which have a legal angle, will go before the court. It will save the time of the Apex Court also.
The Act has been introduced with the view to keep surveillance over the activities carried out by the enterprises. It’s role is more advisory than supervisory. Thus in a way it is user friendly.

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**ANNEXURE ‘A’**

**TRIGGERING LIMITS PRESCRIBED BY THE ACT FOR COMBINATIONS U/S SECTION 5**

<table>
<thead>
<tr>
<th>Sr.No.</th>
<th>Criteria</th>
<th>Value of Assets</th>
<th>Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>In case of any acquisition or acquiring of control the parties to the acquisition or acquiring of control if jointly have in India:</td>
<td>More than Rs. 1000 Crores</td>
<td>More than Rs. 3000 Crores</td>
</tr>
</tbody>
</table>
2. In case of any acquisition or acquiring of control the parties to the acquisition or acquiring of control if jointly have in India or outside India

3. In case of any enterprise would belong after acquisition or acquiring of control to a group and the group has in India :

4. In case of any enterprise would belong after acquisition or acquiring of control to a group and the group has in India or outside :

5. In case of any merger or amalgamation the enterprise created as a result of merger or amalgamation have in India :

6. In case of any merger or amalgamation the enterprise created as a result of merger or amalgamation has in India or outside :

7. In case of any enterprise created or remaining after merger or amalgamation is or would belong to a group and the group has or would have in India:

8. In case of any enterprise created or remaining after merger or amalgamation is or would belong to a group and the group has or would in India or outside:

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**ANNEXURE ‘B’**

**QUANTUM OF PENALTY PROPOSED**

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Section</th>
<th>Quantum of Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Indulging in an agreement prohibited by section 3 or abuse of dominant position by an enterprise as contemplated by section 4</td>
<td>27(b)</td>
<td>Not exceeding 10 % of the average of the turnover for the last three preceding financial years.</td>
</tr>
</tbody>
</table>
b) If the agreement as referred to in section 3 is engaged by a cartel, then penalty is leviable on each member of a cartel 27(b) proviso Amount equivalent to 3 times of the amount of profits made out of such agreement or 10% of the cartel’s turnover for the preceding three financial years.

ANNEXURE ‘C’

Relevant Accounting Standards Issued By The Institute Of Chartered Accountants Of India, New Delhi

<table>
<thead>
<tr>
<th>Sr.No.</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>AS -1</td>
</tr>
<tr>
<td></td>
<td>Disclosure of Accounting Policies</td>
</tr>
<tr>
<td>2.</td>
<td>AS - 2</td>
</tr>
<tr>
<td></td>
<td>Valuation of Inventories</td>
</tr>
<tr>
<td>3.</td>
<td>AS -5</td>
</tr>
<tr>
<td></td>
<td>Net Profit or loss for the period, prior period items, and</td>
</tr>
</tbody>
</table>
Change in Accounting Policies

4. AS-6 Depreciation Accounting
5. AS-7 Accounting for Construction contracts
6. AS-9 Revenue Recognition
7. AS-10 Accounting of Fixed Assets
8. AS-11 Accounting of effects of changes in foreign exchange rates
9. AS-13 Accounting of Investments

As on date there are 29 Accounting Standards issued by the Institute. The above are only recommendatory. In practice all the accounting standards shall be required to be equally dealt at the time of investigation.

ANNEXURE ‘E’

Relevant Auditing And Assurance Standards As Issued By The Institute Of Chartered Accountants Of India, New Delhi

<table>
<thead>
<tr>
<th>Sr.No.</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>AAS-2 Objective and Scope of Audited Financial Statements</td>
</tr>
<tr>
<td>2.</td>
<td>AAS -5 Audit Evidence</td>
</tr>
<tr>
<td>2.</td>
<td>AAS - 9 Using the work of an Expert</td>
</tr>
</tbody>
</table>
3.  AAS -14  Analytical Procedures
4.  AAS-16  Going Concern
5.  AAS-19  Subsequent Events
6.  AAS-23  Related Parties
7.  AAS-28  Auditor’s report on Financial Statement
8.  AAS-30  External Confirmation

As on date there are 32 Auditing and Assurance Standards issued by the Institute. The above are only recommendatory. In practice all the accounting standards shall be required to be equally dealt at the time of investigation.